

# **Study of the Taxation of Electronically Delivered Products**

**Final Report  
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**Prepared Pursuant to  
Chapter 522, Laws of 2007 (SHB 1128)**

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## **Study of the Taxation of Electronically Delivered Products**

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## **Introduction**

In 2007, the Washington State Legislature directed the Department of Revenue (Department) to “conduct a study of the taxation of electronically delivered products.” Chapter 522, Laws of 2007 (SHB 1128), requires a committee made up of legislative members and members representing different segments of government and industry assist the Department.

This report does not contain specific recommendations. It identifies issues that should be addressed in proposals considered by the Legislature.

### **Why study the taxation of electronically delivered products?**

The 2007 Legislature enacted chapter 182, Laws of 2007 (ESHB 1981) to provide retail sales and use tax exemptions for sales of electronically delivered standard financial information to investment management companies or financial institutions.

SHB 1128, enacted after ESHB 1981, noted that ESHB 1981 limits the exemptions, now codified as RCW 82.08.705 and 82.12.705, to a specific type of electronically delivered product. SHB 1128 also explained that the taxation of other types of electronically delivered products, including standard financial information, remains a policy question.

SHB 1128 directed the Committee to review the following issues:

- The provision of explicit statutory definitions for electronically delivered products;
- The current excise tax treatment of electronically delivered products in the state of Washington and other states as well as the tax treatment of these products under the Streamlined Sales and Use Tax Agreement (SSUTA);
- The administration, costs, and potential recipients of the tax exemptions provided in ESHB 1981; and
- Alternatives to the excise taxation of electronically delivered products.

During 2007 and 2008, the Committee for the Study of the Taxation of Electronically Delivered Products (Committee) met nine times. On November 30, 2007, the Department presented a preliminary report to the House Finance and the Senate Ways & Means Committees.

## **Problem Statement**

The Committee identified the following concerns regarding the taxation of electronically delivered products, also referred to as digital products, in Washington State:

1. Current excise tax law lacks specificity, which leads to a lack of transparency and certainty, and results in disagreements between the Department of Revenue, taxpayers, and those charged with the collection and remittance of the tax. This could result in class action lawsuits being filed by customers of those charged with collecting and remitting the tax;
2. Application of current law may not be durable in the face of changing technology.
3. Developing a tax policy that treats conventional and digital goods equally in all instances will be difficult;
4. As new digital goods and existing conventional goods are digitized, Washington and local governments may face a reduction of the retail sales and use tax base if digital goods are removed from the retail sales and use tax base;
5. Many digital activities can be easily moved to other jurisdictions to avoid tax liability; and
6. To continue to tax products delivered electronically while remaining in conformity with the SSUTA, Washington must adopt a statute specifically authorizing the taxation of such items.

## **Vision & Goals Statement**

During the Committee's initial meetings, the Committee agreed that any recommendations made to the Legislature should promote the following goals:

1. Simplicity and fairness;
2. Conformity with the SSUTA;
3. Neutrality regardless of industry, content, and delivery method while taking the purchaser's underlying property rights into account;
4. Consideration given to the revenue impact of potential changes to the tax base;
5. Consideration given to the impact caused by the pyramiding of business inputs;
6. Maintaining or enhancing the competitiveness of businesses located in Washington; and
7. Maintaining certainty, consistency, durability, and equity despite changes in technology and business models.

## Issues Associated with the Taxation of Digital Products

As the Committee investigated the potential taxation of digital products, the discussions focused on several broad issues. The Committee believes that the Vision and Goals adopted by the Committee in the Preliminary Report should be used to resolve these issues and develop a potential taxation proposal.

### What does continued compliance with SSUTA require with regard to the taxation of digital products?

In September 2007, the SSUTA defined electronically delivered products (digital products) as not being tangible personal property. As of January 1, 2010, to stay in compliance with the SSUTA, Washington may not continue to impose retail sales tax on the sale of certain specified digital products as the sale of tangible personal property. As of 2010, the SSUTA requires that retail sales and use taxes imposed on the purchase of specified digital products must be separately imposed from the general imposition of retail sales and use taxes on the purchase of tangible personal property. As of January 1, 2012, this requirement is extended to all other digital products.

To maintain compliance with the SSUTA, the Legislature has three options with regard to the taxation of digital products.

**No Imposition:** The Legislature could amend the definition of tangible personal property to exclude digital products. As a result, the sale of digital products would no longer be subject to retail sales and use taxes.

**Specific imposition:** The SSUTA defines three specified electronically delivered products: digital audio works (music), digital audio-visual works (movies), and digital books (books). Any other digital products fall into the undefined “other” group of “electronically delivered products.” The SSUTA allows Washington to choose to tax only digital music, movies, and books and not tax any other digital products, or to tax some combination of the specified digital products. If there are other individual digital products that the Legislature wants to tax, SSUTA allows those additional products to be defined and included with any or all of the SSUTA defined specified digital products the Legislature decides to tax.

**General imposition:** The SSUTA allows states to tax all digital products. A general imposition that is compliant with the SSUTA does not need to use the SSUTA definitions for specified digital products (digital audio works, digital audio-visual works, and digital books) if the statute imposing tax on products transferred electronically is broad enough to encompass what is included in specified digital products. However, some Committee members expressed a preference for incorporating the SSUTA specified digital products definitions into a general imposition statute.

### What issues are raised by the alternatives for digital products taxation?

The first alternative – not taxing any digital products – has the benefit of simplicity. However, both state and local governments would lose revenue. The Committee also discussed the

economic advantage this alternative would create for competing products; some tangible products would be taxed while competing digital products would not.

The key difference between the two remaining alternative approaches – general imposition and specific imposition – is that a general imposition presumes that the sale of all digital products will be taxed unless specifically exempted while a specific imposition presumes that the sale of any digital product not specifically enumerated will not be taxed.

The general imposition approach has the advantage of flexibility because it accommodates changes in future technology and business practices without repeated legislative amendments. The general imposition approach also embodies the traditional approach to taxing sales of tangible personal property by presuming sales are taxable unless specifically exempted. The Committee also discussed specific imposition on taxable items and whether it is desirable for the Legislature to carefully consider the individual circumstances in determining whether tax should be imposed on a specific product.

The option for a general imposition statute, depending upon how it is drafted, could also expand the scope of sales and use taxation of digital products. This is discussed in more depth below.

### **Should tax only apply to digital products with a tangible equivalent?**

Discussions about the tax treatment of digital products usually involve examples of taxing digital and tangible versions of the same product. People tend to describe digital products in relation to a more familiar tangible product that is similar in some respect. For example, people often compare the taxation of the sale of a music CD to the taxation of the sale of an MP3 digital music file or the taxation of the rental of a DVD movie to the taxation of the rental of a digital movie streamed over the Internet. Some suggest that tax policy in the digital world should follow the policies already established for equivalent tangible products.

The SSUTA considered and ultimately rejected a tangible equivalent test. This rejection was, in part, because of the many combinations of user rights available and the constantly evolving types and uses of electronically delivered products. The infinite number of potential combinations makes it hard to compare tangible and digital products. For example, is a movie recorded on DVD the tangible equivalent of the same movie made available over the Internet with links to interactive features not available in the DVD format?

Although the tangible equivalent concept assists people in an initial understanding of the issues by placing digital products in a conventional context, that approach ultimately raises more questions than answers. As the digital world grows and matures, it is developing its own unique products. As a result, a tangible equivalent test lacks clarity. Such a test cannot provide clear guidance as to which products are equivalent to tangible products, and therefore taxable, and which are not.

The federal Internet Tax Freedom Act (ITFA) raises similar issues. ITFA contains an anti-discrimination clause that preempts states from taxing online products at a higher rate than “similar” offline products. Thus, ITFA incorporates a tangible equivalent test in the anti-

discrimination clause. No cases have been reported interpreting the anti-discrimination clause; its future application to digital products is uncertain.

### **How will digital codes be treated?**

Digital products may be obtained through the use of a digital code. Digital codes are sometimes used in promotional campaigns. For example, a soft drink company, as part of a promotion, might purchase digital codes from a distributor of digital music. The soft drink company then gives away the digital codes to customers who purchase its soft drink products. Those customers use the digital code to download songs from the digital music distributor's web site.

The SSUTA contains rules regarding the tax treatment of digital codes. A digital code is defined in the SSUTA as a code "which provides a purchaser with a right to obtain one or more [digital products] having the same tax treatment." Under the SSUTA, the taxation of digital codes must be the same as the digital product to which the code relates. In other words, if a state imposes sales tax on the retail sale of digital music, sales tax must also apply to the retail sale of a digital code used to obtain digital music.

However, a code that allows the purchaser to obtain multiple digital products that do not all have the same tax treatment is not a digital code under the SSUTA. Any legislation to impose sales and use tax on digital products should clarify the tax treatment of these types of codes. One way to clarify the tax treatment of the sale of these types of codes is to treat them as a bundled transaction. See below for a discussion of bundled transactions.

### **How would digital services be treated?**

The advent of the Internet and extensive computer services has created a new world of products for consumers. These services often incorporate opportunities for consumers to interact with the products in new ways. For example, a consumer could purchase a movie to be streamed over the Internet, complete with the ability to search for similar movies or other movies that star the same actors. The distinction between traditionally taxable goods and nontaxable services blurs as more supplemental content and services become available.

The Committee discussed a proposal to tax "digital automated services" under a general imposition approach. Digital automated services would include any service furnished via a computer network that involves an automated process and that utilizes one or more software applications. Digital automated services would not include any service that primarily involves the application of human effort, and the human effort originated after the customer requested the service. For example, a help desk service that uses an "instant messenger" to allow the client to "chat" with the technician would not be a digital automated service. However, a searchable database of "help desk" articles, tips, and Q&A's would generally be considered digital automated services, the sale of which would be subject to retail sales tax under a general imposition tax that includes digital automated services.

Some suggest it would be very simple to tax digital automated services under a general imposition approach. A general imposition statute eliminates the need to distinguish specific taxable products by not attempting to specifically define each taxable event. Others nonetheless prefer the specific imposition approach, arguing that the uncertain nature of these distinctions

requires the close attention of legislators before tax is imposed. They also point to the inconsistency of broadly imposing tax on digital automated services when sales tax is only applied to specific retail services under current law.

### **What are the B&O tax implications of taxing digital products and services?**

The decision whether to subject the sale of digital products and services to retail sales and use taxes also carries business and occupation (B&O) tax implications. Under current law, a sale of digital products and services that is not treated as a retail sale is subject to tax under the Service and Other classification of the B&O tax at a rate of 1.5%. Retail sales of digital products are subject to B&O tax under the Retailing classification at a rate of 0.471%. To the extent that the sale of digital products and services is made subject to retail sales and use taxation, the seller would benefit from the corresponding reduction in B&O tax rates.

In addition, businesses taxable under the Service and Other B&O tax classification are typically entitled to apportionment if the business operates in more than one state. On the other hand, Retailing B&O taxes are allocated according to the location of the sale. Thus, a business located in Washington that sells digital products that are not subject to Retailing B&O tax and retail sales tax currently must pay Service & Other B&O tax on income from all such sales, but may be entitled to apportion that income if the business has a taxable presence in other states. To the extent these digital products are made subject to Retailing B&O tax and retail sales tax, the business would pay Retailing B&O tax and collect retail sales tax only on sales to Washington consumers. In many cases, such businesses would experience a substantial reduction in B&O tax liability.

### **Will user rights affect taxability?**

Digital products may be sold under circumstances where the seller grants the buyer either the right of permanent use of the product or a nonpermanent right to use the product. Under a right of permanent use granted by the seller, the buyer may use the product in perpetuity. Under a nonpermanent right of use granted by the seller, the buyer's right to use the product terminates in the future. The sale of the right to view a digital movie for three days is an example of a sale of a digital product with a right of nonpermanent use granted by the seller.

The SSUTA provides member states flexibility to tax digital products sold with permanent rights of use and also digital products that are sold with nonpermanent rights of use. However, member states choosing to tax digital products sold with a nonpermanent right of use granted by the seller must specifically impose and separately enumerate the tax on such sales.

If the Legislature imposes tax on digital products, it must determine whether to tax permanent and nonpermanent user rights regardless of whether it chooses a general or specific imposition approach.

The Committee discussed how taxing only permanent user rights results in inequitable treatment in some circumstances. For example, DVD rentals are currently taxed, but a time-limited digital movie would not be taxed.



### **Will subscription sales of digital products be taxed?**

The SSUTA allows states to tax or not tax subscription sales of digital products. For purposes of this report, a subscription sale occurs when the sale of digital products is conditioned upon continued payment from the purchaser. For example, the right to access a library of digital music for a monthly fee is a subscription sale of digital products. To be compliant with the SSUTA, member states choosing to tax this type of transaction must specifically impose and separately enumerate the tax on such sales.

The same equity arguments raised above for permanent use have been raised regarding this issue.

### **Will the method of obtaining digital products affect taxability?**

Digital products may be delivered to the buyer, for example, by download. Digital products may also simply be accessed by the buyer without delivery to the buyer. The Department's position is that under current law sales and use taxes only apply with respect to digital products that are delivered to the buyer.<sup>1</sup> Thus, digital products streamed to the buyer are not currently subject to sales or use tax because there is no delivery to the buyer.

The current application of sales and use tax to digital products, which depends on the method of obtaining the product, is not technology neutral; it results in lower taxes on products that are streamed to or accessed by the buyer. The impact of this taxability issue is expected to grow as more digital products are provided on a streamed or access basis. However, extending tax to digital products that are streamed or accessed would also present challenges. For example, sourcing sales of digital products obtained by access may be difficult in some cases, particularly where blind payment methods, such as gift cards or Paypal, are used.

### **Will remote access of prewritten computer software be treated the same as digital products for sales and use tax purposes?**

Under current law, the sale of prewritten computer software is subject to sales or use tax if the software is physically or electronically transferred to the buyer. Merely purchasing the right to access prewritten software located on the seller's or a third parties' server is not subject to sales or use tax in this state.

Objections have been raised to the current taxation of the service of providing access to prewritten computer software because it provides a competitive advantage to software provided in this manner. However, the challenges noted above with respect to taxing digital products that are merely accessed would also apply to the sale of access to prewritten software.

The SSUTA prohibits member states from interpreting the definition of tangible personal property to include any digital products. Under the SSUTA, prewritten computer software is defined as tangible personal property. Thus, the SSUTA treats digital products and prewritten computer software as different products. If the Legislature decides to extend sales and use tax to the service of providing access to prewritten software, to ensure compliance with the SSUTA, the tax should be imposed separately from any tax on digital products.

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<sup>1</sup> See section 4 of the Committee's Preliminary Report, which contains the Department's analysis of current law as it applies to the sale of digital products.

## **How will digital products be sourced?**

When a taxable retail sale occurs, that sale must be “sourced” to a specific location to determine the applicable sales tax. Until recently, Washington used origin-based sourcing. The place from which the goods were shipped determined the sales tax. Beginning July 1, 2008, Washington adopted destination-based sourcing to bring Washington into compliance with the SSUTA. Under destination-based sourcing, the location where the purchaser receives the product determines the applicable sales tax.

Under the SSUTA, sales of digital products are sourced the same as other sales. Sales are sourced according to the following hierarchy:

- The seller’s place of business if the purchaser receives the digital product at the seller’s place of business;
- If not received at the seller’s place of business, the location where the purchaser receives the digital product;
- If the location where the purchaser receives the digital product is not known, the purchaser’s address available in the seller’s business records (absent bad faith);
- If no address is available in the seller’s business records, the purchaser’s address obtained at the time of sale (e.g., purchaser’s payment instrument); and
- If no address is obtained at the time of sale, such as when the purchaser uses a blind payment method (like a gift card or Paypal) to acquire digital products, the address where the digital product is first made available for transmission by the seller.

Concerns were raised about the final default in the sourcing rule. Because digital products need not be delivered to a buyer’s physical address, there will be occasions when digital products are sold but the seller has no information about the buyer’s physical address. In such a case, one likely result of sourcing sales to where the item is first made available for transmission by the seller is a default to the location of server farms. This could create undesirable tax results for merchants who choose to use Washington-based server farms. In an attempt to address this concern, the Committee discussed the possible use of the buyer’s IP (Internet protocol) address as a proxy for a physical address when no other address information is available.

## **What problems are created when digital products are accessed from “multiple points of use”?**

Because digital products are easily accessed for use in multiple locations, multiple jurisdictions may tax the sale or use of the same digital products. The term “multiple points of use” (MPU) is used to describe when this risk of duplicative taxation occurs. For a period of time the SSUTA had provisions regarding MPU. The provisions essentially called for apportioning the tax among the jurisdictions where a digital product is concurrently available for use. Because of concerns expressed by some states and by some elements of the business community, the MPU provisions were removed from the SSUTA. The concerns related to the possibility of multiple taxation and the availability or unavailability of credits for taxes paid to multiple jurisdictions.

Concerns remain that apportionment in the case of MPU is necessary to reduce the risk of multiple taxation. Others point out that Washington acting alone cannot solve this problem and that it requires a national solution.

### **How would bundled digital products be taxed?**

For sales tax purposes, bundling refers to the packaging of taxable and nontaxable items for one nonitemized price. Washington has adopted the SSUTA definitions related to bundling. The SSUTA requires no particular tax treatment for a bundle or for any type of bundle. States are free to tax or not tax bundled transactions or to tax some bundled transactions but not others.

Under current law, Washington taxes bundled transactions with the following exceptions:

- If the value of the taxable items is de minimis (ten percent or less of the total value), the bundle is not taxed;
- If the bundle contains food or medical items and the value of taxable items is fifty percent or less of the total value, the bundle is not taxed; or
- If the bundle contains telecommunication service, ancillary service, internet access, or audio or video programming service, the bundle is taxed unless the seller chooses to charge tax only on the taxable elements and can justify the amount of tax based on its books and records.

Concern has been expressed that the bundling provisions in current law would lead to taxation of otherwise nontaxable items. If a seller engaged in electronic commerce bundles a nontaxable service with a taxable digital product and the taxable digital product is worth more than ten percent of the total value, the entire price would be taxable.

The bundling concerns are not unique to digital products. The same issues exist with the taxation of bundled tangible goods and services.

If the Legislature decides to impose tax on digital products, the current bundling rules would apply to bundles that include digital products. However, several alternatives are available if the Legislature decides to address bundling issues. The Legislature could:

- Provide that the entire bundled purchase is subject to retail sales tax;
- Provide that the entire bundled purchase is not subject to retail sales tax;
- Provide that a flat percentage of the transaction is taxable; or
- Allow taxpayers to unbundle using the taxpayer's books and records so that only the taxable products in the bundle are subject to sales tax.

### **Will the digital representation of professional services be taxed?**

The Committee agrees that digital products that represent professional services, such as those performed by accountants, architects, and lawyers, are not and should not be subject to retail sales tax. For example, retail sales tax does not apply if a lawyer e-mails a will drafted for a specific client simply because the will was e-mailed to the client as a digital document.

Not all digital products, however, represent professional services. The key to determining whether a digital product is merely the representation of a professional service depends on whether the true object of the transaction is the sale of professional services or of a digital product. This determination often turns on the amount of interactivity between the client and the

professional. For example, a standard form “fill in the blank” will drafted by an attorney and sold electronically via download to multiple customers would not be the representation of professional services and would be subject to retail sales tax. This is because the true object of the transaction is the sale of the digital product (the standard will form), not professional services that have been individualized for the client.

### **Should the distinction between information services and standard information be retained?**

A great deal of the Committee’s discussion focused on the Department’s current analysis of the taxation of information services and standard information. The Department takes the position that information services include not only the subset of digital products that represent a professional service, but also include reports and other information that are created for a specific client (analogous to custom software created for one client versus prewritten software that is sold to multiple clients). The Department further believes that standard information is uniform data offered or sold to multiple clients. For example, a company creates a report based on car owner demographics recommending a marketing campaign that it sends electronically to a client. This single report would be considered information services delivered electronically, which is not subject to retail sales tax. If this same report were sold and delivered electronically to multiple clients interested in marketing campaigns based on car owner demographics, then the sale would be subject to retail sales tax as the sale of standard information. If the client just wanted the demographic information to run its own analysis, the demographic information would be standard information unless the selling company gathered its own demographic information specifically for that client.

Within the Committee, some suggest applying the same type of analysis to tax digital products and digital automated services within the general imposition without capturing information services.

### **How would current “Internet services” be treated?**

RCW 82.04.297 defines “Internet services.” Currently, the gross income from Internet services is subject to B&O tax under the Service & Other classification. The Committee discussed the current definition of Internet services in RCW 82.04.297 and how it may or may not encompass many items that could be considered digital products or digital automated services. Examples of possible overlap are “computer processing applications” and “hosting of information for retrieval,” which are included within the definition of Internet service, but could also fall within the definition of digital products or digital automated services. If the current definition of Internet services were retained, it could result in a definition of digital products or digital automated services that is narrower than contemplated.

To avoid this problem, if the Legislature makes the policy choice to impose tax on digital products, the definition of Internet service in RCW 82.04.297 should align with the tax imposition statute adopted by the Legislature.

### **What exemptions should be provided to businesses that purchase and use digital products and services?**

Under current law, certain business purchases are exempt from sales and use tax or are excluded from the sales and use tax base. (In this report, exemptions and exclusions will be referred to collectively as exemptions.) Two primary exemptions in current law are purchases of tangible personal property for resale and purchases of tangible components or ingredients of a new product for sale. The Committee agreed that these exemptions should be continued for digital products.

The Committee discussed other possible exemptions for business purchases. These exemption options included:

- **Free give away:** Items of tangible personal property are often given away for free for promotional or other purposes. Likewise, digital products and services (like the maps and directions provided on a free mapping web site) are often given away or made available for free to attract people to web sites or for other reasons. The Legislature could provide a sales and use tax exemption for digital products and services given away or made available for free. Persons receiving the benefit of these digital products or services provided or made available for free would be subject to use tax unless a specific exemption is also provided. However, this would differ from the sales and use tax treatment of tangible items given away for free. Currently, the purchaser of items to be given away for free is considered the consumer of the items and must pay retail sales or use tax. The person who receives the item for free may be subject to use tax if the donor did not pay sales or use tax.
- **Standard data/information:** Like the existing standard financial information exemption, an exemption can be given for the general use of certain types of information or to certain users of standard information.
- **Business purpose:** An exemption for digital products or services used directly in generating business income would create an exemption that is dependent on the purpose for which the purchase is made. For example, digital music purchased by a law firm for the elevator in its building would not be a business purpose generating business income, but that same law firm's purchase of access to a search engine and database of digital case law and periodicals would be a business purpose generating business income.
- **All business inputs:** This is the broadest possible exemption for businesses; it would exempt businesses from paying retail sales and use tax on all digital products purchased. For application purposes, this would be the simplest for businesses. However, this is a much broader business inputs exemption than currently exists in Washington's sales tax structure. Such a broad exemption would reduce the need to address certain issues discussed earlier, such as MPU.

Other exemption options were introduced by members of the Committee and the public.

- Expand existing exemptions to include digital equivalents. This exemption is the converse of the tangible equivalent test issue discussed previously and suffers from the same difficulties in application.
- Exempt personal and interoffice electronically delivered communication (such as e-mail) so that there is no use tax on the value of an e-mail sent internally.

- Exempt digital automated services given away for free.
- Expand the manufacturing machinery and equipment exemption to include digital products used directly in a manufacturing operation.
- Exempt “dynamic information,” which would include any digitized standard information for which periodic updates are provided within a defined time.
- Provide amnesty to taxpayers who failed to pay or collect tax on the purchase of digital products during periods before any legislation imposing tax is enacted. This was suggested due to the disagreement over the application of current law to digital products.

## **Conclusion**

We hope the Legislature finds this report useful as it considers the complex issues raised by the taxation of digital products. The Department appreciates opportunity to work with the Study Committee members and looks forward to continuing to support the members’ efforts to find common ground in this area before the upcoming legislative session.

## **Appendix A – Committee Meetings and Processes**

The Committee for the Taxation of Electronically Delivered Products met during 2007 and 2008, adopting this report in November 2008. The Committee held comprehensive discussions and heard presentations, including those noted below, on topics surrounding the taxation of digital products.

### **The SSUTA**

The Streamlined Sales and Use Tax Agreement (SSUTA) is a cooperative effort of 44 states, the District of Columbia, local governments and the business community to simplify and make more uniform sales and use tax collection and administration by retailers and states.<sup>2</sup> Washington State became a full member of the Streamlined Sales and Use Tax Governing Board on July 1, 2008. As discussed in the Issues section of this report, the SSUTA is a key consideration for Washington in the taxation of digital products.

### **Current Law Taxation of Digital Products**

Department staff made a presentation on the current taxation of digital products. Alternative interpretations were also presented. The preliminary report to the Legislature's fiscal committees included decision trees addressing the interpretations of current law.<sup>3</sup>

### **Survey of the Taxation of Digital Products**

Department staff surveyed and reported back to the Committee on how the 50 states, the European Union, and Canada tax digital products.<sup>4</sup> The surveys and a list of citations are available on the Department's web site.

### **Alternatives for the Taxation of Digital Products**

Six committee members presented alternatives for the taxation of digital products. In addition to identifying advantages and disadvantages, the Committee discussed the various alternatives.<sup>5</sup>

### **Sample Language for the Taxation of Digital Products**

The Committee found it useful for discussion purposes to draft and review sample statutory language to better define the concepts and issues. Sample language was created for the Committee's discussion comparing a general imposition approach and a specific imposition approach, as well as different business input exemptions.<sup>6</sup>

### **Revenue Impacts**

Department staff presented estimates for retail sales and use tax revenue received as a result of the current taxation of digital products. Based on Fiscal Year (FY) 2008 and projected through FY 2018, the estimate compared digital products to conventional goods.

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<sup>2</sup> To view the SSUTA, visit the Streamlined Sales Tax Governing Board's web site at [www.streamlinedsalestax.org](http://www.streamlinedsalestax.org).

<sup>3</sup> The Preliminary Report is available under "Documents" on the Department's web site pages for the study at <http://dor.wa.gov/Content/AboutUs/StatisticsAndReports/DigitalGoods>.

<sup>4</sup> The surveys and a list of citations are available under "Documents" on the Department's web site pages for the study.

<sup>5</sup> The alternatives are available under "Documents" on the Department's web site pages for the study.

<sup>6</sup> Sample language for potential legislation is available under "Documents" on the Department's web site pages for the study.

Department staff also presented an estimate of revenue based on sample statutory language. Projected from FY 2010 through FY 2019, the estimate included retail sales and use tax changes, business and occupation (B&O) tax changes, and potential exemptions for business inputs.<sup>7</sup>

### **Public Comment**

The Committee and the Department encouraged public participation. Towards this end:

- Interested persons were able to sign up to receive electronic notice of committee meetings and information via a listserve;
- Time for public comment was set aside during each Committee meeting; and
- The Department's Internet site provided information about the Committee's work.<sup>8</sup>

Public testimony is summarized in the Committee's meeting minutes. A list of comments submitted in writing appear in Appendix B and are available on the Department's web site.

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<sup>7</sup> Both estimates are available under "Documents" on the Department's web site pages for the study.

<sup>8</sup> Meeting schedules, committee documents (refer to Appendix A), and audio recordings of meetings are available on the Department's web pages for the study.



## **Appendix B – Committee Documents and Public Submissions**

The Committee's work produced many documents. All documents, and audio recordings of Committee meetings, are available on the Department of Revenue's web site at: <http://dor.wa.gov/Content/AboutUs/StatisticsAndReports/DigitalGoods>.

Available documents include:

- Meeting Agendas.
- Meeting Minutes.
- Meeting Handouts.
  - Draft Language for Major Provisions of a Digital Goods Bill – Changes Based on September 25<sup>th</sup> Discussion, presented by Gil Brewer and Dylan Waits, Department staff. (October 30, 2008.)
  - Additional Draft Language. (October 30, 2008.)
  - Issues from September 25, 2008, for Discussion on October 30, 2008, presented by Gil Brewer and Dylan Waits, Department staff. (October 30, 2008.)
  - AWB Draft Language for Major Provisions of a Digital Goods Bill, presented by Ron Bueing, Committee member. (October 30, 2008.)
  - AWB Legislative Objective – Digital Products Tax Policy, presented by Ron Bueing, committee member. (October 30, 2008.)
  - Draft Outline of Final Report. (October 30, 2008.)
  - Draft Language for Major Provisions of a Digital Goods Bill, presented by Drew Shirk and Mark Mullin, Department staff. (September 25, 2008.)
  - Additional Draft Language. (September 25, 2008.)
  - Estimates presented by Dr. Stephan Smith, Department staff. (September 25, 2008.)
  - Digital Goods Neutrality Proposal presented by Committee Chair Ross Hunter. (August 12, 2008.)
  - Possible Outline of Final Report. (September 25, 2008.)
  - Committee Member Presentations. (May 29, 2008.)
    - Tax Policy for Inputs to Digital Goods: Reproduction and Redistribution Rights in Digital Goods Distributed With or Without a Charge, presented by Bruce Reid, Committee member.
    - Dynamic Information delivered electronically, presented by Steve Collier, Committee member.
    - AWB Presentation on Digital Goods, presented by Ron Bueing, Committee member.
    - Presentation, presented by Paula Borhauer, Committee member.
    - Final Report Proposal, presented by Julie Murray, Committee member.
    - On the Taxation of Digital Goods and Services Delivered over the Internet, presented by Gregory M. Silverman, Committee member.
  - 50-State Taxation of Digital Products and Citations, presented by Dylan Waits, Department staff. (April 24, 2008.)
  - European Union's (EU) Taxation and Sourcing of Digital Products, presented by Dylan Waits, Department staff. (April 24, 2008.)

- Canada's Taxation and Sourcing of Digital Products, presented by Dylan Waits, Department staff. (April 24, 2008.)
- Potential Revenue Impacts, presented by Dylan Waits, Department staff. (April 24, 2008.)
- Tax Treatment by Other Jurisdictions of Digital Products, presented by Dylan Waits, Department staff. (November 15, 2007.)
- Digital Products Overview presented by Rich Prem, Committee member. (October 15, 2007.)
- Digital Goods Decision Tree, presented by Dylan Waits, Department staff. (October 15, 2007.)
- Substitute House Bill (SHB) 1128 (section 136(3), chapter 522, Laws of 2007, P.V.).
- Engrossed Substitute House Bill (ESHB) 1981 (chapter 182, Laws of 2007)
- Legal Requirements of Members and Committee, presented by JoAnne Gordon, Department staff. (October 2, 2007.)
- Committee Reports
  - November 30, 2007, Preliminary Report.
  - Letter to Senate Ways & Means Committee Chair Margarita Prentice and House Finance Committee Chair Ross Hunter Concerning Delay of Final Report.
  - December       , 2008 Final Report.
- Public Submissions
  - Washington Electronics Association Memorandum, dated April 23, 2008.
  - Additional Draft Language, presented by Ralph Amon, The Boeing Company.

## **Appendix C – SHB 1128**

SHB 1128 (chapter 522, Laws of 2007) directed the Department of Revenue to study the taxation of electronically delivered products with the assistance of a committee. The pertinent language, provided in subsection (3) of section 136, appears below.

(3)(a) \$50,000 of the general fund--state appropriation for fiscal year 2008 and \$25,000 of the general fund--state appropriation for fiscal year 2009 are provided solely to conduct a study of the taxation of electronically delivered products. The legislature recognizes that chapter . . . (Engrossed Substitute House Bill No. 1981), Laws of 2007, relates to specific types of electronically delivered products and does not address the taxation of numerous other types of electronically delivered products. Therefore, a policy question remains concerning the sales and use taxation of other electronically delivered products.

(b)(i) To perform the study, the department of revenue shall be assisted by a committee. The committee shall include four legislative members appointed as follows:

(A) The president of the senate shall appoint one member from each of the two largest caucuses of the senate; and

(B) The speaker of the house of representatives shall appoint one member from each of the two largest caucuses of the house of representatives.

(ii) The department of revenue shall appoint additional members with balanced representation from different segments of government and industry, and shall consider representation from the following areas: Small and large businesses that generate, deliver, or use electronically delivered products; financial institutions; insurers; persons with expertise in tax law in an academic or private sector setting; and persons experienced in working with computers and electronically delivered products. The department of revenue shall appoint additional members from the department with expertise in the excise taxation of electronically delivered products.

(iii) The committee shall choose its chair from among its membership.

(iv) The department and committee shall review the following issues: The provision of explicit statutory definitions for electronically delivered products; the current excise tax treatment of electronically delivered products in the state of Washington and other states as well as the tax treatment of these products under the streamlined sales and use tax agreement; the administration, costs, and potential recipients of the tax exemptions provided in chapter . . . (Engrossed Substitute House Bill No. 1981), Laws of 2007; and alternatives to the excise taxation of electronically delivered products.

(v) Legislative members of the committee are reimbursed for travel expenses in accordance with RCW 44.04.120. Nonlegislative members of the committee, except those representing an employer or organization, are entitled to be reimbursed for travel expenses in accordance with RCW 43.03.050 and 43.03.060.

(c) The department shall report its preliminary findings and recommendations to the appropriate fiscal committees of the legislature by November 30, 2007. The department shall provide the final report of its findings and recommendations to the appropriate fiscal committees of the legislature by September 1, 2008.

## **Appendix D - ESHB 1981**

ESHB 1981 (chapter 182, Laws of 2007), codified as RCW 82.08.705 and 82.12.705, provided sales and use tax exemptions for the purchase and use of electronically delivered standard financial information by an investment management company or financial institution.

AN ACT Relating to excise taxation of electronically delivered financial information; adding a new section to chapter 82.08 RCW; adding a new section to chapter 82.12 RCW; and providing an effective date.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

**NEW SECTION.** **Sec. 1.** A new section is added to chapter 82.08 RCW to read as follows:

(1) The tax levied by RCW 82.08.020 shall not apply to sales of electronically delivered standard financial information, if the sale is to an investment management company or a financial institution.

(2) For purposes of this section and section 2 of this act, the following definitions apply:

(a) "Financial institution" means a business within the scope of chapter 82.14A RCW.

(b) "Investment management company" means an investment adviser registered under the investment advisers act of 1940, as amended, that is primarily engaged in providing investment management services to collective investment funds. For purposes of this subsection (2)(b), the definitions in RCW 82.04.293 apply.

(c)(i) "Standard financial information" means any collection of financial data or facts, not generated or compiled for a specific customer including, but not limited to, financial market data, bond ratings, credit ratings, and deposit, loan, or mortgage reports. It does not include reports furnished as part of a service described in RCW 82.04.050(3).

(ii) For purposes of this subsection (2)(c), "financial market data" means market pricing information, such as for securities, commodities, and derivatives; corporate actions for publicly and privately traded companies, such as dividend schedules and reorganizations; corporate attributes, such as domicile, currencies used, and exchange where shares are traded; and currency information.

**NEW SECTION.** **Sec. 2.** A new section is added to chapter 82.12 RCW to read as follows:

The provisions of this chapter shall not apply with respect to the use, by an investment management company or a financial institution, of electronically delivered standard financial information.

**NEW SECTION.** **Sec. 3.** This act takes effect August 1, 2007.

## ***Acknowledgements***

The Department appreciates the contributions of the Committee's members and staff that assisted with the Study.

### **Committee Members**

Ross Hunter	Washington State House of Representatives
Joe Zarelli	Washington State Senate
Derek Kilmer	Washington State Senate
Ed Orcutt	Washington State House of Representatives
Paula Borhauer	Starbucks Coffee Company
Ron Bueing	Association of Washington Business
Stephen Collier	Safeco Corporation
Cindi Holmstrom	Department of Revenue
Jim Justin	Association of Washington Cities
Ben Kim	Albers School of Business and Economics, Seattle University
Victor Moore	Washington State Office of Financial Management
Julie Murray	Washington State Association of Counties
Richard Prem	Amazon.com, Inc.
Bruce Reid	Microsoft Corporation
Chuck Robinson	Village Books
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